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SEBI's consultation papers on flexibilities provided to Large Value Funds and the introduction of a separate scheme for Accredited Investors

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Overview

The Securities and Exchange Board of India (SEBI) has released two distinct, yet thematically linked, consultation papers, signalling a significant strategic recalibration of the regulatory landscape for Alternative Investment Funds (AIFs). The core objective of these proposals is to introduce a "lighter-touch regulatory framework" for sophisticated investors. This initiative leverages two central regulatory vehicles: a set of proposed relaxations for Large Value Funds (LVFs) and the introduction of AIF schemes constituting of only Accredited Investors (AI only schemes). While the LVF proposals seek to address immediate regulatory flexibilities by addressing the current operational and compliance constraints, the AI only scheme framework is positioned as a long-term, gradual shift towards a regulatory regime centred around Accredited Investors and tailored exclusively for sophisticated market participants.

These measures are not isolated actions but represent a coordinated effort to foster a more flexible and efficient market for alternative investments. The consultation papers present a series of key proposals that collectively aim to enhance the operational flexibility of AIFs for high-net-worth and institutional investors.

Consultation Paper on Large Value Funds

The consultation paper on LVFs proposes amendments to make LVFs more flexible and attractive. The main purpose is to broaden participation and ease compliance by reducing the minimum investment threshold, removing certain regulatory requirements, and allowing existing eligible AIF schemes to convert into LVFs:

1. Reduction of the minimum investment amount in LVFs from INR 70 crore to INR 25 crore

   Lowering the threshold is expected to broaden investor participation by including domestic institutional investors who are currently excluded due to internal diversification limits and IRDAI exposure caps. While the Working Group recommended aligning the threshold with the INR 10 crore threshold prescribed under SEBI Portfolio Managers Regulations, 2020, for large value Accredited Investors, the proposed INR 25 crore threshold represents a balanced arrangement, a harmonized approach to align the threshold across various asset management regimes could be considered, potentially using the INR 10 crore threshold as a benchmark, so as to avoid potential regulatory arbitrage between different frameworks prescribing varying eligibility criteria for Accredited Investors.

2. Relaxation of NISM certification criteria under Regulation 4(g)(i) for AIFs exclusively running LVF schemes

   It was proposed that LVFs cater solely to Accredited Investors capable of independent due diligence, the NISM certification requirement may offer limited additional investor protection. While the NISM certification requirement may offer limited incremental investor protection in such cases, retaining the certification criteria could contribute to building a more robust and credible asset management ecosystem[1].

3. *Exemption of LVFs from following SEBI's template PPM and from the annual audit of PPM terms*

   Since LVF investors are already accredited and are required to acknowledge their awareness of risks and reduced regulatory oversight upfront through an undertaking, mandating template PPMs and annual audits may be redundant. This exemption would streamline compliance and reduce operational burden, while relying on the sophistication of the investor base.

4. Exemption for Investment Committee members from Regulation 20(8) requirements and from obtaining specific investor waivers for such exemption

   Regulation 20(8) places a duty on the members of the Investment Committee to ensure that all decisions are in compliance with the AIFs policies and procedures, the proviso exempts those AIFs where each investor has committed at least INR 70 crore and has furnished a waiver from compliance with this sub-regulation. Since investors in LVFs already provide an undertaking confirming their risk-bearing capacity, it was proposed that LVFs may also be exempted from obtaining a separate, specific waiver from investors for the purpose of Regulation 20(8).

5. Removal of the cap on the maximum number of investors in LVFs

   The existing 1000 investor cap was largely seen as unnecessary for LVFs, as the high minimum investment and accreditation requirements act as natural constraints on participation. While removing the cap would provide structuring flexibility without materially compromising investor protection, the restriction need not be done away with entirely. Instead, a higher threshold such as a 5000 investor limit may be considered as a more balanced approach.

6. Allowing existing eligible AIF schemes to convert into LVFs and avail related benefits

   Providing a transition mechanism for qualifying AIF schemes would enable broader adoption of the LVF framework and ensure parity in regulatory treatment, allowing existing eligible schemes to benefit from the proposed relaxations.

The proposals aim to make the LVF framework more accessible and efficient, encouraging wider participation while preserving investor sophistication. By lowering entry barriers, and streamlining regulatory compliance, SEBI seeks to attract a broader base of domestic and institutional capital without compromising governance standards.

Consultation Paper on the introduction of a separate scheme for Accredited Investors

The consultation paper outlines a proposal to introduce an option to launch schemes exclusively for Accredited Investors, with a "lighter-touch" regulatory framework. The paper's core objective is to get feedback on a gradual, long-term strategic shift from using a "minimum commitment threshold" to "accreditation status" as the primary indicator of an investor's sophistication.

Limitations of the Existing Minimum Capital Commitment Threshold

SEBI proposed that minimum capital commitment may not accurately reflect investor sophistication, as it denotes only a contractual obligation to provide funds when called, which may not result in actual drawdown, leaving scope for inflated commitments that do not represent true risk appetite or financial capacity. The current threshold of INR 1 crore, which has not been revisited since 2012, appears to be outdated. Moreover, as this requirement is not linked to income or net worth, it was observed that investors may allocate a disproportionate share of their wealth to inherently high-risk alternative investments. Accordingly, the long-term objective is for AIF schemes to comprise exclusively of Accredited Investors:

1. Long-*term vision of gradual transition from 'minimum commitment threshold' to 'only accreditation status'*

[1] Similar qualification requirements such as the Uniform Investment Adviser Law Exam (Series 65) exam in the United States also serve to establish a minimum standard for technical proficiency amongst intermediaries.

As mentioned earlier, since capital commitment levels may not reliably indicate investor sophistication, shifting to an accreditation-based model would align eligibility with an investor's financial capacity and understanding of risk.

2. Co-existence of both the frameworks by providing the option of a separate type of AIF scheme that on-boards only Accredited Investors

   The case for the co-existence of AI-only schemes and LVFs appears limited, as AI-only schemes are not subject to the higher minimum capital commitment requirement yet could benefit from similar regulatory relaxations as LVFs.

3. Exemption from requirement of maintaining rights pari-passu among investors of a fund/scheme, subject to a waiver provided by each investor

   The proposal to permit differentiated rights among investors, subject to individual waivers, is a welcome development, as it would facilitate customised deal structures and tailored commercial terms, thereby enhancing flexibility for sophisticated investors. However, the proposed framework should also ensure that such rights do not grant investors decision-making powers, in order to avoid potential implications under FEMA.

4. Extension of the tenure up to 5 years subject to the consent of subject to approval of two-thirds of the unit holders by value of their investment

   This is a welcome development, given that AI-only schemes are restricted to Accredited Investors and the proposal is consistent with the principles underpinning the LVF framework.

5. Extant responsibilities on trustee of the fund shall solely rest with the Investment Manager

   It is a welcome move that the proposed framework allows the delegation of the Trustee's operational responsibilities under the AIF Regulations to the Investment Manager, while appropriately retaining the fiduciary duties with the Trustee.

Conclusion

The proposed relaxations for LVFs and the introduction of AI only schemes reflect a measured attempt to balance regulatory efficiency and investor protection. This shift reflects SEBI's acknowledgment that India's alternative investment sector requires operational flexibility to compete effectively with global financial centres, particularly given the increasing sophistication of domestic investors and the imperative to channel greater capital flows into the AIF ecosystem.

However, in alignment with SEBI's mandate to safeguard investor interests, the implementation of the proposed light-touch regime may benefit from a holistic approach that thoughtfully balances enhanced market accessibility with the need for investor protection.

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